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C O N F I D E N T I A L                    ANKARA 00408

SIPDIS

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C O N F I D E N T I A L SECTION 01 OF 03 ANKARA 000408

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TREASURY FOR INTERNATIONAL AFFAIRS KMATHIASEN AND JROSE

E.O. 12958: DECL: 02/26/2012

TAGS: ECIN EFIN EU TU

SUBJECT: TURKISH MINISTER DESCRIBES EU AND ECONOMIC REFORM STRATEGIES TO A/S SULLIVAN

REF: ANKARA 378

Classified By: Ambassador Ross Wilson for reasons 1.4(b) and (d).

¶1. (C) Summary: Turkish Minister of Economy and EU Negotiator Ali Babacan described the profound transformation of Turkey as a more transparent, globally-interconnected country to visiting EEB A/S Sullivan on February 10. Following the EU's December suspension of negotiations over eight chapters, Turkey would sequence reform based on its own priorities and continue to move forward in all areas. Babacan said that under the German Presidency Turkey's accession process seems to be going better than expected. On the macroeconomic situation, Babacan asserted that the composition of the current account deficit and how it was being financed mitigated to some extent the risk of a sharp adjustment, as did Turkey's reduced public debt and banking sector vulnerabilities. Babacan admitted the Government might go slower on things like privatization during this election year in order to return as a single-party government and achieve more reforms in over the long term. End Summary.

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Babacan Describes Turkey's Transformation  
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¶2. (C) Minister of Economy and EU Negotiator Ali Babacan met with A/S Sullivan, Ambassador and Treasury's Karen Mathiasen February 10 on the margins of the U.S.-Turkey Economic Partnership Commission (EPC) meetings. After A/S Sullivan briefed on the EPC and his trip to the region, Babacan launched into an analysis of the profound changes currently under way in Turkey. The large number of legislative reforms require a

changed mindset but this has come more slowly, particularly for the judiciary and police whom he characterized as "inward-looking." He said after some judicial exchange programs with EU countries, Turkish judges are increasingly acting in accordance with rulings of the European Court of Human Rights.

¶ 13. (C) Babacan said Turkey had become more transparent and more connected with the outside world which made the changes more irreversible. The explosion of radio and tv channels and the growth of the internet were key. He said the government had put 600,000 computers into Turkish schools, and the goal is to have internet access in every school in Turkey. As a result, even young children are following the news. He linked the public reaction to the Dink assassination to these changes, saying ten years ago it would have been different. Moreover, in the 1960's or 70's events were not immediately reflected in financial markets. Seventy percent of the value of shares traded on the Istanbul Stock Exchange is held by foreigners. With the markets vulnerable to radical changes, "no one wants to be the reason things go wrong in the market."

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Turkey's Revised Approach on EU Accession

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¶ 14. (C) Babacan described Turkey's latest thinking on how to approach the EU accession process since the EU froze negotiations on eight chapters over the Ankara Protocol issue. Babacan said it is now clear that Turkey will be ready for the EU before the EU is ready for Turkey. The Government attributes the recent problems in Turkey's accession process to matters internal to the EU: problems digesting recent members, the constitution impasse, low economic growth, energy security, etc. In addition, Turkey is not like any other accession country. By the time it joins, it will be the largest country by population and area, it will have the largest single-country bloc in the European Parliament, and it will be the region's sixth largest economy. Babacan said the Turkish public's support for EU accession peaked at 75% in October 2005 but now was around 55%. He attributed the fall to a feeling that the EU doesn't want Turkey. Though other accession countries had also experienced declines in support for accession, in the other countries the support fell later in the process as difficult reforms were implemented.

¶ 15. (C) Babacan said that since December, Turkey can no longer justify measures to the Turkish parliament or people by saying the EU required them. Reforms would have to be justified on the basis of being good for Turkey on their own merits. In January the Government decided to prepare its own timetable for enactment of the EU acquis. Since Turkey will not need to have implemented the acquis until it becomes a member, before that time the sequencing will depend on Turkey's priorities. Babacan used the example of the chapter on Environment, implementation of which is expected to cost between 50 and 80 billion Euros (public and private sectors combined), a cost that Turkey can not afford to bear over a period as short as 5 to 7 years.

¶ 16. (C) But Babacan emphasized that the Government continued to believe the accession process was beneficial for Turkey, and he insisted that work was continuing on all chapters. The Government message to the public is that "We are doing this for ourselves, because it is good for Turkey." When it seemed Cyprus would block chapters aside from the eight chapters suspended over the Ankara Protocol issue, Babacan said Turkey had told the EU they could not continue. Under the German Presidency, however, things are turning out better than expected, with invitations to open chapters. The EU's movement on reducing the isolation of northern Cyprus was also positive. He said Turkey targets closing one chapter by the end of March and two more by the end of June.

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Working on European Public Opinion

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¶ 17. (SBU) Babacan acknowledged the importance of public opinion in EU countries, especially France, which will have to hold a referendum

on Turkish accession. Babacan said even a single visit to Turkey tends to have an impact on Europeans' perceptions. Turkey now receives 22 million Euros in grants for people-to-people exchanges including local government and youth exchange programs, and the funding will increase. Forty thousand students have already gone on exchange programs and a total of three hundred eighty thousand are expected by 2013. In addition, EU tourism to Turkey is increasing, as are EU-origin individual real estate investors. Total real estate investment by foreigners (mostly from EU countries) grew from \$800 million in 2004 to \$1.5 billion in 2005 to \$3 billion in 2006. Babacan repeated his contention that other Muslim countries are watching Turkey's EU process as an important sign of the West's attitude toward Islam. A/S Sullivan thanked Babacan for his analysis and reiterated U.S. support for Turkey's EU accession process.

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Babacan Downplays Vulnerabilities, Current Account Deficit  
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¶8. (SBU) Babacan downplayed Turkey's vulnerabilities and the current account deficit (CAD) problem. He said people are coming to understand the importance of the composition of the high CAD: "we are importing machines, not chocolates." Energy imports shot up from \$9 billion in 2002 to \$29 billion in 2006, almost entirely due to price increases. At constant prices, 2006 energy imports would have cost \$13 billion. Babacan said the other mitigating factor is the availability of financing and its composition. Whereas foreign direct investment (FDI) used to average about \$1 billion a year, Turkey attracted \$9.5 billion in 2005 and around \$20 billion in 2006, 85-90% of EU origin. Babacan said total long-term flows in the Capital Account are larger than the CAD. Finally, Babacan pointed to the importance of a floating exchange rate regime as a shock absorber.

¶9. (SBU) The Government nevertheless continued to monitor the CAD closely, according to Babacan. Public debt ratios have improved, and the banking sector is far stronger. The Bank regulatory agency (BRSA) tells him that banks do not take significant foreign exchange risk positions. The explosive growth of credit card and housing loans has now stabilized while bank credit to corporations is taking off -- a healthy sign of private sector investment. Babacan also linked the Government's continued adherence to fiscal austerity to prudence arising from the large CAD.

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Reform in the Election Year  
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10.(C) Despite Presidential and Parliamentary elections in 2007, Babacan asserted that Turkey would continue strong fiscal and monetary policies and would push forward as much reform as possible. He effectively admitted, however, that with parliament distracted by politics, the Government's would opt not to push too hard on difficult issues (such as privatization) before elections, the better to return to power with a single-party government that will be able to achieve more reform in the long run.

A/S Sullivan has cleared this cable.

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WILSON